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No. 88-1265

In the Supreme Court of the United States

OCTOBER TERM, 1988

ANTHONY J. FAGIANO, DIRECTOR, DEPARTMENT OF INSURANCE OF IDAHO, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether an Idaho statute establishing the priority of various classes of claims against the assets of a liquidating insurance company regulates the "business of insurance" within the meaning of Section 2(b) of the McCarran-Ferguson Act, 15 U.S.C. 1012(b), so as to displace the priority conferred by 31 U.S.C. 3713 for claims by the federal government.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A28) is reported at 858 F.2d 445. The opinion of the district court (Pet. App. A29-A36) is reported at 662 F. Supp. 60.

JURISDICTION

The judgment of the court of appeals was entered on September 7, 1988. A petition for rehearing was denied on October 31, 1988 (Pet. App. A37). The petition for a writ of certiorari was filed on January 27, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner Fagiano, the Director of the Idaho Department of Insurance, is the liquidator of two insol-

vent companies, Pacific Insurance Administrators Agency, Inc., and Pacific Insurance Administrators, Inc., formerly engaged in the insurance business in Idaho. In 1983, because of their financial problems, the companies agreed to cease doing business, to surrender possession of their assets to the Director, and to accept liquidation. During the liquidation process, the United States submitted claims for federal taxes owed by the insurance companies showing that Pacific Insurance Administrators Agency, Inc., owed the United States $25,514, and that Pacific Insurance Administrators, Inc., owed the United States $88,482. Pet. App. A4-A5.

The State of Idaho has laws that regulate insurance companies, including provisions that address the liquidation of insolvent insurance companies. See Idaho Insurers Supervision, Rehabilitation and Liquidation Act, Sections 41-3301 through 41-3360 of the Idaho Code. Section 41-3342 of the Idaho Code establishes a priority scheme for the payment of claims against a liquidated insurer in which governmental claims receive a lower priority than claims of general creditors. Pet. App. A6.[1]

The Director, as liquidator of the two companies, assigned a fifth priority to the government's tax claims pursuant to the Idaho statute. This priority would not have allowed the government to collect its delinquent taxes because the liquidation proceeds were insufficient to pay

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[1] The priority scheme of Section 41-3342 provides generally for the payment of eight classes of claims according to the following priority: administrative expenses (Class 1), certain wage claims of employees (Class 2), claims for policy losses (Class 3), claims under nonassessable policies and claims of general creditors (Class 4), governmental claims (Class 5), late filed claims in classes 1-5 (Class 6), surplus or contribution notes and premium refunds on assessable policies (Class 7), and claims of shareholders or owners (Class 8). See Pet. App. A26-A28.

both fourth priority claims, which consisted principally of the claims of approximately 150 general creditors, and fifth priority claims. The government asserted, however, that the priority of its claims was governed by the Federal Insolvency Statute, 31 U.S.C. 3713. That statute provides that claims of the United States shall be paid first whenever an insolvent person indebted to the federal government has made a voluntary assignment of property or has committed an act of bankruptcy. Pet. App. A6-A7.[2]

2. The Director obtained an order from the Ada County District Court permitting him to set aside funds to pay the government's claims, and he then brought this interpleader action in the United States District Court for the District of Idaho to resolve the priority dispute (Pet. App. A7). Relying on Section 2(b) of the McCarran-Ferguson Act, 15 U.S.C. 1012(b), the Director contended that State law controlled the priority of the federal government's claims. Section 2(b) provides in pertinent part that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to the business of insurance" (see Pet. App. A38). The district court agreed with this contention and held that the priorities in liquidation were governed by the Idaho statute (Pet. App. A29-A36). The court reasoned that Section 41-3342 of the Idaho Code was part of the overall regulatory scheme of the insurance industry established by Idaho and therefore that the provision regulated the "business of insurance" within the meaning of the McCarran-Ferguson Act (Pet. App. A34-A35).

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[2] Section 3713 does not apply to cases under the federal bankruptcy statute. Insurance companies are excluded from that statute. 11 U.S.C. 109(b)(2).

3. The court of appeals reversed (Pet. App. A1-A28), concluding that Section 41-3342 does not regulate the "business of insurance" within the meaning of the McCarran-Ferguson Act. The court observed that "both Congress and the courts have declared that the McCarran-Ferguson Act was not intended to open new areas of regulatory discretion to the States" (Pet. App. A13). Rather, the court explained, the McCarran-Ferguson Act was intended only to return to the states the power to regulate insurance transactions that had been put in doubt by *United States* v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944).[3] Quoting this Court's decision in *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 460 (1969), the court of appeals stated that the term "business of insurance" in the McCarran-Ferguson Act refers primarily to "[t]he relationship between insurer and insured" (Pet. App. A17). The court concluded that, under *National Securities,* the Idaho statutory provision, which addresses only a situation where the business of insurance has ceased and "is wholly unrelated to the relationship between insurer and insured," cannot be encompassed within Section 2(b) of the McCarran-Ferguson Act (Pet. App. A18-A19). The court of appeals added (*id.* at A19-A23) that the Idaho statute also does not satisfy any of the criteria of a statute regulating the "business of insurance" that this Court later identified in the progeny of *National Securities—Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205 (1979), and *Union Labor Life Ins. Co.* v. *Pireno,* 458 U.S. 119 (1982).

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[3] *South-Eastern Underwriters* overruled an earlier decision holding that insurance transactions were not "commerce," and it created concern over the continued validity under the Commerce Clause of existing state regulatory and taxing schemes. See Pet. App. A12-A13; pages 5-6, *infra.*

ARGUMENT

The court of appeals correctly held that the Idaho statute does not regulate the "business of insurance" within the meaning of the McCarran-Ferguson Act. That decision fully accords with the relevant decisions of this Court and does not conflict with any decision of another court of appeals.[4] Indeed, this Court recently denied certiorari in a case raising precisely the same issue presented here. *Gordon* v. *United States Dep't of the Treasury*, 846 F.2d 272 (4th Cir.), cert. denied, 109 S. Ct. 390 (1988). There is no more reason to grant certiorari here than there was in *Gordon*.

1. There is no merit to petitioners' contention (Pet. 8-12, 18-20) that the Idaho statute pertains to the "business of insurance" within the meaning of the McCarran-Ferguson Act simply because part of the liquidator's duties are to consider and pay the claims of policyholders of the insolvent insurance companies. Once an insurance company is in liquidation, it is no longer in the business of insurance. While the insurer's assets must be distributed among various creditors, some of whom are policyholders

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[4] The decision below is also in accord with the only state appellate court decision of which we are aware that addresses this issue, *Langdeau* v. *United States*, 363 S.W.2d 327 (Tex. Civ. App. 1962). The court in *Langdeau* rejected the contention that a state statute establishing a priority for unpaid wage claims over federal tax claims on the liquidation of an insurance company constituted regulation of the "business of insurance" under the McCarran-Ferguson Act. The court explained that "[t]here are many statutes regulating the rights of persons who may have claims against an insurance company * * * yet it would hardly be contended that these laws regulate the insurance business simply because they may be invoked against an insurance company" (*id.* at 331). The court held, accordingly, that the United States had priority under the predecessor of Section 3713 for its claims for unpaid taxes and interest thereon.

with claims based on their policies, the determination of the priority according to which those claims should be paid is a matter of insolvency administration, not the "business of insurance."

The history of the McCarran-Ferguson Act makes clear that it was never intended to sweep so broadly as to permit the states to determine priorities in insolvency proceedings without regard to otherwise applicable federal law. The McCarran-Ferguson Act was enacted in response to this Court's decision in *United States* v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), in which the Court held that interstate insurance transactions are "commerce" subject to Congress's power to enact legislation under the Commerce Clause. The McCarran-Ferguson Act was designed to allay fears that, as a result of this holding, traditional state regulation of insurance could be invalidated by negative implication of the Commerce Clause. It is clear, however, that the McCarran-Ferguson Act was intended only to *return* the regulation of insurance transactions to the states, not to expand the power of the states to act in the face of conflicting federal statutes. As this Court explained in *SEC* v. *National Securities, Inc.*, 393 U.S. at 459:

> The McCarran-Ferguson Act was an attempt to turn back the clock, to assure that the activities of insurance companies in dealing with their policyholders would remain subject to state regulation. As the House Report makes clear, "[i]t [was] not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the *Southeastern*

> *Underwriters Association* case." H.R. Rep. No. 143, 79th Cong., 1st Sess., 3 (1945).

The Court reiterated this explanation in *Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205, 218 n.18 (1979) (emphasis deleted), stating that the "primary purpose of the McCarran-Ferguson Act was to preserve state regulation of the activities of insurance companies, as it existed before the *South-Eastern Underwriters* case," that is, to permit the States to continue such regulation "without fear of Commerce Clause attack." See also *Maryland Casualty Co.* v. *Cushing*, 347 U.S. 409, 413 (1954) (plurality opinion); H.R. Rep. No. 143, 79th Cong., 1st Sess. 3 (1945); H.R. Rep. No. 68, 79th Cong., 1st Sess. 2 (1945).

It follows that the "business of insurance" in the Act does not encompass regulation of the priority accorded to debts owed to the federal government by an insolvent insurance company. The priority accorded to debts owed to the federal government has never been regarded as a matter within the province of state regulation; rather, that matter has been governed by the Federal Insolvency Statute since virtually the beginning of the Republic. See Act of Mar. 3, 1797, ch. 20, § 5, 1 Stat. 515, as amended by Act of Mar. 2, 1799, ch. 22, § 65, 1 Stat. 676; *United States* v. *Oklahoma*, 261 U.S. 253, 259 (1923). And, prior to the enactment of the McCarran-Ferguson Act, it was not doubted that the statute was fully applicable to insolvency of insurance companies. See *United States* v. *Knott*, 298 U.S. 544, 547 (1936). Moreover, this long-standing federal statute has no connection with the Commerce Clause concerns that prompted the McCarran-Ferguson Act; it derives from Congress's comprehensive powers under Article I, Section 8 of the Constitution to "pay the Debts" and to establish "uniform Laws on the

subject of Bankruptcies." See *United States* v. *Fisher*, 6 U.S. (2 Cranch) 358, 396 (1805). Thus, the decision below and that of the Fourth Circuit in *Gordon* have not created a "legal quagmire" (Pet. 15); they simply reaffirm that, despite the McCarran-Ferguson Act, the Federal Insolvency Statute continues to apply according to its terms to determine the priority of debts owed to the government in state insolvency proceedings.[5]

As the court of appeals explained (Pet. App. A16-A19), this Court's decision in *National Securities* itself makes plain that the McCarran-Ferguson Act extends to the states exclusive regulatory authority only over those activities of insurance companies that constitute the business of insurance, which does not encompass the priority provision involved here. In *National Securities,* the Court held that an Arizona statute under which the State Director of Insurance had approved the merger of two insurance companies did not regulate the "business of insurance" and therefore the McCarran-Ferguson Act did not allow it to displace the operation of the federal securities laws. The Court explained that the Arizona statute regulated the relationship between stockholders and insurance companies, not "between insurer and insured" (393 U.S. at 460). Similarly here, the court of appeals correctly concluded that the Idaho priority statute does not regulate the relationship between an insurer and its policyholders, but rather regulates the relationship among the various creditors of insolvent corporations, albeit corporations

[5] Petitioners' contention (Pet. 16) that this Court should grant review to resolve a "conflict" between the Idaho statute and the Federal Insolvency Statute is misconceived. Such a "conflict" is resolved by the Supremacy Clause of the Constitution, and petitioners' plea that "[t]his Court should not allow a general application federal statute to override the provisions of a narrowly tailored state insurance statute" (*ibid.*) is foreclosed by that Clause.

that had engaged in the business of insurance. Such regulation of the relationship between one creditor and another is far afield from the "business of insurance" to which the McCarran-Ferguson Act is directed.[6]

Moreover, both the court below (Pet. App. A19-A23) and the Fourth Circuit in *Gordon* v. *United States Dep't of the Treasury*, 846 F.2d at 273-274, correctly concluded that the three criteria articulated in *Group Life & Health Ins. Co.* v. *Royal Drug Co., supra,* and *Union Labor Life Ins. Co.* v. *Pireno*, 458 U.S. 119, 129 (1982), for determining whether a state-regulated activity constitutes the "business of insurance" within the meaning of the McCarran-Ferguson Act all support the decision below. Contrary to amicus curiae's suggestion (NAIC Amicus Br. 10-12), the Idaho statute plainly does not regulate the spreading of *insurance* risks—the transfer of the insurance risk "is complete at the time that the [insurance] contract is entered" (*Pireno*, 458 U.S. at 130). Nor does the statute address an integral part of the policy relationship between the insurer and the insurer; instead, it governs the rela-

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[6] Petitioners clearly err in suggesting (Pet. 17) that the priority provision, Section 41-3342 of the Idaho Code, must be regarded as regulation of the "business of insurance" because it is part of a comprehensive statutory scheme enacted by the Idaho legislature to regulate the insurance industry in Idaho. As the court of appeals stated, this contention "begs the question" whether the "specific provision constitutes the type of regulation that Congress sought to protect from indirect federal preemption by passing the McCarran-Ferguson Act" (Pet. App. A24). Surely, a state legislature cannot bring a regulation that does not address the "business of insurance" within the scope of the McCarran-Ferguson Act simply by placing the provision in the midst of a set of provisions that generally regulate the business of insurance. The determination whether Congress intended to grant exclusive regulatory authority to the states on a particular matter cannot depend upon where the state's regulatory provision is placed in its statutory code.

tionship between creditors, including all creditors of the insurance company and not merely the policyholders. And the statute establishing the priority of all creditors' claims manifestly is not limited in its effect to entities within the insurance industry; it governs the creditor's rights of a variety of entities outside the insurance industry.

Petitioners urge (Pet. 11) that these three criteria are applicable only where the antitrust exemption of the McCarran-Ferguson Act is at issue, as was the case in both *Royal Drug* and *Pireno*. First, even if this contention had merit, it would not avail petitioners since the court of appeals was correct in concluding (Pet. App. A16-A19) that it is unnecessary to refer to the antitrust exemption cases in order to conclude that the statute at issue here does not regulate the "business of insurance." In any event, petitioners' contention is clearly mistaken.

Both *Pireno* and *Royal Drug*, like this case, applied Section 2(b) of the McCarran-Ferguson Act. By its terms, that section resolves any conflict between an "Act of Congress" that does not "specifically relate[] to the business of insurance" and a state law "enacted * * * for the purpose of regulating the business of insurance." In this regard, Section 2(b) does not distinguish between antitrust statutes and other statutory provisions, and thus it permits no variation in the meaning of the phrase "business of insurance" that is dependent upon the particular federal statute involved. If a state law regulates the "business of insurance," it supersedes all inconsistent general federal statutes; if it does not, it is subordinate to all such federal laws. Indeed, this Court has repeatedly referred to the three criteria identified in *Pireno* and *Royal Drug* as generally delineating the scope of the phrase "business of insurance" under the McCarran-Ferguson Act, without suggesting that their use should be restricted to the antitrust context. See *Pilot Life Ins. Co.* v. *Dedeaux*, 481 U.S.

41, 48-49 (1987); *Metropolitan Life Ins. Co.* v. *Massachusetts*, 471 U.S. 724, 743 (1985).

2. There is no merit to petitioners' contention (Pet. 12-15) that the decision below creates a conflict in the circuits that requires resolution by this Court. The suggestion that the court of appeals' decision conflicts with the Fourth Circuit's decision in *Gordon* is fanciful. Both courts held that, despite the McCarran-Ferguson Act, the terms of the Federal Insolvency Statute override a state statute assigning priorities to the claims of creditors of an insolvent insurance company. Both courts ruled that this reading of McCarran-Ferguson is compelled by application of the three criteria identified by this Court in *Royal Drug* and *Pireno*. The only difference in the two decisions is that, in the instant case, the court of appeals also stated that the same result is compelled by an earlier decision of this Court, *National Securities*, without the need to resort to the three-factor test. Thus, there is no conflict at all between the two decisions, much less one that warrants a grant of certiorari.

Nor does the decision below conflict in any way with the other cases cited by petitioners, which all involved the "abstention doctrine" and did not apply the McCarran-Ferguson Act to find a federal statute inapplicable because a state statute was viewed as regulating the "business of insurance." The Second and Tenth Circuit cases (*Grimes* v. *Crown Life Ins. Co.*, 857 F.2d 699 (10th Cir. 1988), cert. denied, No. 88-1155 (Mar. 27, 1989); *Law Enforcement Ins. Co.* v. *Corcoran*, 807 F.2d 38 (2d Cir. 1986), cert. denied, 481 U.S. 1017 (1987); *Levy* v. *Lewis*, 635 F.2d 960 (2d Cir. 1980)) each presented the issue whether it was appropriate for the federal court to exercise its discretionary power to abstain from adjudicating a claim against an insolvent insurance company, where the state regulatory scheme committed such claims to a single state liquidation

proceeding. In resolving that issue, the courts recognized the policies underlying the McCarran-Ferguson Act as a factor weighing in favor of abstention. But in none of the cases did the courts hold that state law displaced a federal right or that an insurer liquidation statute regulates the "business of insurance."[7] Indeed, the Second Circuit in *Levy* made clear that the federal law that had been invoked (ERISA) was not subordinated to state law under the McCarran-Ferguson Act, stating that "the Act was meant only to free state regulation 'of the business of insurance' [quoting *National Securities,* 393 U.S. at 459-460], not regulation of insurers as employers * * *." 635 F.2d at 966. See also *Lac D'Amiante du Quebec, Ltee.* v. *American Home Assurance Co.,* 864 F.2d 1033, 1039 n.8 (3d Cir. 1988) (noting that abstention inquiry does not require determining whether state regulation constitutes regulation of the business of insurance within the meaning of McCarran-Ferguson Act).

The other case relied upon by petitioners, *United Services Auto. Ass'n* v. *Muir,* 792 F.2d 356 (3d Cir. 1986), cert. denied, 479 U.S. 1031 (1987), did not even concern an insolvent insurance company. The issue there was whether a federal court should abstain from deciding whether a Pennsylvania statute, which prohibited an insurer that owned a bank in another state from simultaneously conducting an insurance business in Pennsylvania, was either unconstitutional or preempted by federal banking legislation. 792 F.2d at 359-360. Moreover, the court ruled that abstention was not appropriate

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[7] *Grimes* and *Law Enforcement Ins. Co.* did not even involve claims grounded in federal law (see 857 F.2d at 705; 807 F.2d at 44), and therefore they clearly do not suggest that a federal rule of substantive law governing priority of federal claims against an insolvent debtor must give way to a contrary state statute.

in that case, stating both that regulation designed to prevent competition between insurers and Pennsylvania financial institutions is not regulation of the "business of insurance" under the McCarran-Ferguson Act and that the Pennsylvania statute is not otherwise so integral to the state's complex regulatory scheme governing insurance as to justify invoking the doctrine of abstention. 792 F. 2d at 364-365. Plainly, the decision below does not conflict with *United Services*.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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